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Recent Developments in Reporting Requirements for Foreign Investors in the United States*†

by Kevin Conboy**

This article updates reporting requirements for foreign investors in the United States.¹ Parts I and II discuss recent developments in the Commerce Department² and Agriculture Department³ reporting requirements respectively; part III updates The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA).⁴

FIRPTA has been a troubled piece of legislation from its inception. The Treasury Department has encountered enormous difficulty in issuing regulations that are both reasonable and faithful to FIRPTA, and the final contours of the reporting requirements under FIRPTA remain very much in doubt. The present administration has indicated its intention to amend FIRPTA to provide for a system of tax withholding, rather than the present system, which gives the taxpayer a choice between filing information returns and providing the Internal Revenue

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† Subsequent to the preparation of this article, on July 18, 1984, the Deficit Reduction Act of 1984 was enacted. This Act amended FIRPTA to provide for tax withholding, a change from the former enforcement system, which required affected taxpayers either to file information returns or to provide the IRS with security for the payment of the tax.

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¹ For background and additional citations of authority, see Gornall & Wharton, *Significant Non-Tax Reporting Requirements Relating to Investment in the United States by Foreign Persons*, 7 N.C.J. INT'L L. & COM. REG. 163 (1982).

² The Commerce Department reporting requirements are found in the International Investment Survey Act of 1976, 22 U.S.C. §§ 3101-3108 (1982), and in 15 C.F.R. §§ 806.1-17 (1983).

³ The Agriculture Department reporting requirements are set out in the Agricultural Foreign Investment Disclosure Act of 1978, 7 U.S.C. §§ 3501-3508 (1982), and in 7 C.F.R. §§ 781.1-1.5 (1983).

⁴ Foreign Investment in Real Property Act of 1980, Pub. L. No. 96-499, 94 Stat. 2599, 2682 (codified as amended at I.R.C. §§ 861(a)(5), 897, 6039C, 6652(g) (1982) (hereinafter cited as FIRPTA). FIRPTA was amended by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 831, 95 Stat. 172, 352, (codified as amended at I.R.C. §§ 862, 897 & 6039C (1982)). FIRPTA received much attention from the legal community when it was first passed. See, e.g., Feder, *Planning Under the Foreign Investment in Real Property Act of 1980*, 59 TAXES 81 (Feb 1981); Feder & Parker, *The Foreign Investment in Real Property Tax Act of 1980*, 34 TAX. LAW. 545 (1981); Mihaly, *Tax Treatment of Gains Realized by Foreigners on Sale of U.S. Real Property*, 16 INT'L LAW. 95 (1982); Newton, *Tax Planning: Foreign Investment in United States Real Property*, 12 GA. J. INT'L & COMP. L. 1 (1982); Richards, *Telling the Taxman: Reporting and Avoidance Under FIRPTA*, 17 REAL PROP. PROB. & TR. J. 1 (1982). FIRPTA again received much attention after implementing regulations, but much of what was then written is no longer valid due to changes in the regulations. See *infra* notes 32-128 and accompanying text.

Service (IRS) with security for the payment of the prospective tax liability.

Part IV of this article contains a summary of restrictions and reporting requirements imposed by the various states on foreign investment in real property. Finally, Part V contains a few practical tips for dealing with reporting requirements.

I. International Investment Survey Act

Only one significant change has been made in the reporting requirements under the International Investment Survey Act of 1976.⁵ On January 26, 1984, the Bureau of Economic Analysis (BEA) issued a final rule⁶ raising the criteria for exemptions from periodic reporting to BEA. Under prior law, foreign investments of more than \$5 million in total assets, annual sales or gross operating revenues, or annual net income after provision for U.S. income tax were subject to quarterly reports for transactions with the foreign parent.⁷ Foreign investments meeting the threshold above, and foreign investments involving the acquisition of 200 or more acres of U.S. real estate were also subject to detailed annual reports.⁸ Under the new rule, the dollar level for an exemption from periodic reporting has been raised from \$5 million to \$10 million for both quarterly and annual reporting, and the 200 acre exemption criteria has been eliminated.⁹ These changes will lighten reporting burdens for a number of foreign persons investing in U.S. farmland and timberland. BEA also announced its intention to create a new exemption claim form for exemptions from annual reporting.¹⁰

BEA still has shown no real proclivity toward imposing penalties on foreign investors who fail to file required reports with the BEA. The "whistle blowing" feature of the Commerce Department reporting scheme, however, remains troublesome.¹¹ The instructions for Form BE-14 require that it be filed no later than forty-five days after the direct investment transaction occurs by

a U.S. person — including, but not limited to, an intermediary, a real estate broker, business broker, and a brokerage house — who assists or intervenes in the sale to, or purchase by, a foreign person or a U.S. affiliate of a foreign person of a 10 percent or more voting interest in a U.S. business enterprise, including real estate¹²

⁵ 22 U.S.C. §§ 3101-3108 (1982).

⁶ See 49 Fed. Reg. 3,173-74 (1984) (amending 15 C.F.R. §§ 806.15(h), (i) (1983)). This rule is identical to an earlier rule proposed on November 21, 1983. See 48 Fed. Reg. 52, 591-92 (1983).

⁷ See U.S. Dep't of Commerce, Forms BE-605 and BE-606 (1983).

⁸ 15 C.F.R. §§ 806.15(h),(i) (1983). See U.S. Dep't of Commerce, Form BE-15 (1983); Gornall & Wharton, *supra* note 1, at 165.

⁹ 49 Fed. Reg. 3,173-74 (1984).

¹⁰ The new form will be called Form BE-15, Supplement C, and will be similar to U.S. Dep't of Commerce, Form BE-13, Supplement C (1983).

¹¹ See 15 C.F.R. § 806(j)(4) (1983); Gornall & Wharton, *supra* note 1, at 166.

¹² U.S. Dep't of Commerce, Instructions to Form BE-14 (1983).

The only exemptions from the requirement are for (1) investments of small size, reportable on BE-13 Supplement C rather than Form BE-13; (2) investments if the foreign involvement is not known to the U.S. person; and (3) investments if the U.S. person otherwise required to file Form BE-14 actually files Form BE-13 reporting the investment.¹³ Reading the instructions literally, all U.S. persons involved in a foreign investment transaction with knowledge of the foreign element — the real estate broker, and the attorneys, accountants, and bankers for the foreign investor and any U.S. seller involved — must file Form BE-14. A fourth exemption from the Form BE-14 filing requirement was developed administratively for U.S. persons who have a "good-faith belief that Form BE-13 has been filed."¹⁴ Recent conversations, however, with the BEA official whose statements provided the basis for the fourth exemption indicate that this is no longer the case. It is now BEA's position that Form BE-14 should be filed unless the U.S. person is "certain" that a Form BE-13 reporting the investment was filed.¹⁵ A practical method for dealing with this questionable¹⁶ and troublesome reporting requirement is described in Part V of this article.

II. Agricultural Foreign Investment Disclosure Act

A. Reports

The Agricultural Foreign Investment Disclosure Act of 1978 (AFIDA)¹⁷ imposes an obligation on foreign investors in U.S. farmland and timberland to report their investment to the government. On October 11, 1983, the Agricultural Stabilization and Conservation Service (ASCS) of the Department of Agriculture issued a proposed rule that would make modest changes in the regulations governing the reporting requirements for foreign investors in U.S. agricultural land.¹⁸ The proposed rule is expected to become final, with some changes, in the Spring of 1984.

At present, Form ASCS-153 must be filed in triplicate with the ASCS office in the county where the land is located within ninety days of land acquisition or transfer whenever a foreign person (including a U.S. corporation more than five percent held by foreign individuals or foreign legal entities) acquires an interest (other than a security interest) directly or indirectly in agricultural land.¹⁹ The proposed rule would raise the

¹³ *Id.*

¹⁴ *Id.* See Gornall & Wharton, *supra* note 1, at 166.

¹⁵ Telephone interviews with Joseph E. Cherry III, of BEA.

¹⁶ See Gornall & Wharton, *supra* note 1, at 166. Similar ethical considerations might arise for accountants and other agents and representatives of the foreign investor.

¹⁷ 7 U.S.C. §§ 3501-3508 (1982).

¹⁸ 48 Fed. Reg. 46,065 at 46,065-69 (1983) (to be codified at 7 C.F.R. § 781.1 to 781.5) (proposed Oct. 11, 1983).

¹⁹ 7 C.F.R. § 781.3 (1983). See Gornall & Wharton, *supra* note 1, at 168. "Foreign person" includes a U.S. corporation if it is more than 5% owned by foreign individuals or foreign legal entities. 7 C.F.R. § 781.2(g)(4)(ii), 781.2(f) (1983).

foreign ownership level from five percent to ten percent and would add a provision that whenever the *total* foreign ownership percentage of a tract of agricultural land exceeds fifty percent, Form ASCS-153 must be filed.²⁰

Agricultural land is presently defined as land used for agricultural, forestry, or timber production.²¹ The proposed rule would add *ranching* to the definition of agricultural land.²² If land acquired by a foreign person is idle, the determination as to whether the transaction must be reported is made by looking to see whether it has been used for agricultural purposes within the past five years. This look-back rule is unchanged by the proposed rule.²³

The summary of the changes made by the proposed rule, prepared by ASCS and published in the *Federal Register* along with the proposed rule, indicates that the proposed rule contains a new requirement "that the information in the reports be kept current."²⁴ Despite the language from the summary, the proposed rules contain no such substantive provision, but there is a penalty for failure to comply with the non-existent substantive provisions.²⁵ It is likely, however, that the final rule issued will contain a requirement that foreign investors update certain basic information contained on ASCS-153.²⁶ If the update requirement has narrow application, perhaps it will not add significantly to the burden of this reporting scheme.

B. Exemptions

There is, at present, a *de minimis* exemption from the reporting requirement for the acquisition by a foreign person of one acre or less of agricultural land, so long as gross annual receipts from the sale of products of the land are less than \$1,000.²⁷ The proposed rule would raise the *de minimis* exemption level from one acre to ten acres, but would retain the \$1,000 restriction on gross receipts.²⁸

C. Disclosure of Ultimate Owner

Under present rules, the interposition of three legal entities or "tiers" between the U.S. agricultural land and the ultimate foreign owner protects against the disclosure of the ultimate beneficial owner.²⁹ That protective device is preserved under the proposed rule.³⁰

²⁰ 48 Fed. Reg. 46,067 (1983) (to be codified at 7 C.F.R. § 781.2(k)).

²¹ 7 C.F.R. § 781.2(b) (1983).

²² 48 Fed. Reg. at 46,006 (1983) (to be codified at 7 C.F.R. § 781.2(b)).

²³ 7 C.F.R. § 781.2(b) (1983).

²⁴ 48 Fed. Reg. 46,065 (1983).

²⁵ *Id.* at 46,068 (to be codified at 7 C.F.R. § 781.4(a)(2)).

²⁶ Telephone conversations with officials at ASCS.

²⁷ 7 C.F.R. § 781.2(b) (1983).

²⁸ 48 Fed. Reg. 46,066 (1983) (to be codified at 7 C.F.R. § 781.2(b)).

²⁹ See 7 C.F.R. § 781.3(f), (g) (1983).

³⁰ See 48 Fed. Reg. 46,065 at 46,068 (1983) (to be codified at 7 C.F.R. § 781.3(f), (g)).

D. Penalties

The penalty provisions and appeal procedure under AFIDA have been changed in one respect. If a foreign investor appeals a determination of apparent liability by the ASCS (*i.e.*, ASCS intends to impose a penalty for failure to comply with the provisions of AFIDA and regulations thereunder) and loses the appeal, the foreign investor can be penalized no more than the amount indicated on the original notice of apparent liability sent to him by the ASCS.³¹

III. The Foreign Investment in Real Property Tax Act of 1980

On December 5, 1980, former President Carter signed into law the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA).³² It subjects the gain derived by foreign investors from the disposition of U.S. real property interests to U.S. income taxation.³³ It also contains reporting and disclosure requirements designed to assist the IRS in the collection of taxes imposed by FIRPTA.³⁴

On September 21, 1982, the Treasury Department issued long-awaited regulations (the 1982 Regulations) under parts of FIRPTA.³⁵ The 1982 Regulations contained comprehensive, complex reporting and disclosure requirements. The 1982 Regulations, however, did not address certain parts of Section 897 (the taxing provision of FIRPTA) of the Internal Revenue Code (Code).³⁶ These parts include the nonrecognition and the partnership provisions.

The 1982 Regulations were also seriously deficient in a number of other important respects. The 1982 Regulations under Section 6039C (the reporting and security provisions of FIRPTA) went to great lengths to ensure that every conceivable investment structure by which foreigners own U.S. real property fell within the coverage of FIRPTA, and to explain what information would be required if the foreign investor chose to file information returns.³⁷ The 1982 Regulations, however, were extremely sketchy regarding the security alternative to filing information returns. The absence of meaningful guidance to taxpayers regarding the security alternative eventually forced the IRS, four days before a crucial deadline, to postpone the deadline for applying for security.³⁸ This eleventh-hour postponement epitomizes the confusion and disarray that the

³¹ *Id.* at 46,069 (1983) (to be codified at 7 C.F.R. § 781.5(f)).

³² I.R.C. §§ 861(a)(5), 897, 6039C, & 6652(g) (1982). *See supra* note 4.

³³ *Id.* §§ 861(a)(5), 897 (1982).

³⁴ *Id.* §§ 6039C, 6652(g) (1982).

³⁵ Treas. Reg. §§ 6a.897-1 to -4 (1982); *id.* §§ 6a.6039C-1 to -5 (1982). Both sets of regulations were adopted in T.D. 7832, 1982-1 C.B. 122.

³⁶ I.R.C. § 897 (1982).

³⁷ *See* Treas. Reg. §§ 6a.897-2, 6a.6039C-2 to -4 (1982).

³⁸ *See* U.S. Internal Revenue Service, News Release IR-83-50, [1983] 10 STAND. FED. TAX REP. (CCH) ¶ 6454 (Mar. 17, 1983) (announcement of intention to postpone deadline). The deadline was formally postponed in T.D. 7890, 1983-1 C.B. 305.

implementation of FIRPTA has caused both the government and taxpayers.

It is hoped that final regulations, also long-awaited, will simplify both the reporting and the security alternatives. The first set of revised regulations (the 1983 Regulations),³⁹ issued in November 1983 in proposed form and revising the 1982 Regulations under Section 897, are promising. This part of the article attempts the modest task of explaining the contours of FIRPTA and the current regulations thereunder. The usefulness of the discussion is limited because of the increasing possibility that FIRPTA will be amended to provide for the withholding of any tax due. Its usefulness is also limited because, although the focus of this article is reporting requirements, the Section 6039C portion of the FIRPTA regulations has not been revised yet.

A. *Taxation under FIRPTA*

The taxation of gains realized by foreign investors upon the disposition of their U.S. real estate investments is governed by Section 897 of the Code, which was added by FIRPTA. This section provides that any gain realized by a nonresident alien individual or a foreign corporation from the disposition of a "United States real property interest" shall be taken into account as if the foreign taxpayer were engaged in a U.S. trade or business during the taxable year, and as if the gain were effectively connected with the trade or business.⁴⁰ As effectively connected income, the gain will be taxed at rates comparable to those imposed on domestic taxpayers,⁴¹ except that in the case of nonresident alien individuals, the minimum tax rate will be twenty percent.⁴² If the gain is long-term capital gain (gain from the sale of a capital asset held for more than one year), it will be taxed at a maximum rate of twenty-eight percent for corporations and twenty percent for individuals.⁴³ If, however, the gain is short-term capital gain (gain from the sale of a capital asset held for one year or less), or is gain from the sale of real property that is not a capital asset, then the gain will be taxed at ordinary income rates.⁴⁴ These rates currently range from zero to fifty percent for individuals, and from fifteen to forty-six percent for corporations.⁴⁵

Section 897 of the Code applies to gain realized upon the disposition of a "United States real property interest." That term is generally defined in Section 897(c) of the Code to mean (1) any interest in real prop-

³⁹ Prop. Treas. Reg. §§ 1.897-1 to 1.897-4 (1983), 1983-48 I.R.B. 9.

⁴⁰ I.R.C. § 897(a)(1) (1982).

⁴¹ *Id.*

⁴² *Id.* § 897(a)(2) (1982).

⁴³ I.R.C. § 1201(a)(2) (1982). The 20% individual rate is obtained from *id.* § 1202(a) (1982), allowing a deduction from gross income equal to 60% of net yearly long-term individual capital gains. Hence only 40% of such gains are taxable. Multiplying this figure by the 50% maximum individual rate, *id.* § 1 (1982), yields the 20% figure.

⁴⁴ See I.R.C. §§ 1202, 1221 (1982).

⁴⁵ I.R.C. §§ 1, 11 (1982).

erty located in the United States, or (2) any interest (other than an interest solely as a creditor) in any *domestic* corporation (other than most publicly traded corporations), unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation during the shorter of (a) the period after June 18, 1980, during which the taxpayer held such interest, or (b) the five-year period ending on the date of disposition of such interest.⁴⁶

The term "interest in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds, and options.⁴⁷ In addition, the term "real property" includes personal property associated with the use of real property, such as movable walls and furnishings.⁴⁸ In elaborating on the term "interest other than an interest solely as a creditor," the regulations make it clear that any form of equity participation in real property will be an interest other than an interest solely as creditor. For example, so-called "equity kickers" in loan agreements are interests in real property under the regulations.⁴⁹

The term "United States real property holding corporation" (USRPHC) includes any corporation the fair market value of whose U.S. real property interests equals or exceeds fifty percent of the fair market value of (1) its U.S. real property interests; (2) its interests in real property located outside the United States; and (3) all other assets used or held for use in a trade or business.⁵⁰ For purposes of determining whether a corporation is a USRPHC, it is treated as owning its proportionate share of the assets of partnerships in which it is a partner, trusts and estates in which it is a beneficiary, and other corporations in which it owns, directly or indirectly, fifty percent or more of the fair market value of all classes of stock.⁵¹

FIRPTA also imposes a tax on a portion of the gain realized by a nonresident alien individual or foreign corporation from the sale of an interest in a partnership, trust, or estate owning U.S. real property interests.⁵² Although regulations have not yet been issued under this part of FIRPTA, the tax will be imposed on the foreign partner's or beneficiary's pro rata share of the appreciation in value of the U.S. real property interests of the partnership, trust, or estate.

Stock in a foreign corporation owning U.S. real property does not constitute a U.S. real property interest. Any gain realized upon the sale of the stock, therefore, will not be treated as effectively connected income

⁴⁶ I.R.C. § 897(c)(1)(A) (1982).

⁴⁷ I.R.C. § 897(c)(6)(A) (1982).

⁴⁸ I.R.C. § 897(c)(6)(B) (1982).

⁴⁹ Treas. Reg. § 6a.897-1(d)(3)(i) (1982); Prop. Treas. Reg. § 1.897-1(d)(2)(i) (1983) (U.S. real property interest includes "any direct or indirect right to share in the appreciation in the value of, or in the gross or net proceeds or profits generated by, the real property").

⁵⁰ I.R.C. § 897(c)(2) (1982).

⁵¹ Treas. Reg. § 6a.897-2(h) to -2(j) (1982); Prop. Treas. Reg. § 1.897-2(e) (1983).

⁵² I.R.C. § 897(g) (1982).

subject to the tax imposed by FIRPTA. FIRPTA, however, contains other provisions that effectively prevent a foreign investor from selling the stock of the corporation at a price that reflects the unrealized appreciation of the underlying U.S. real estate, but which does not reflect the FIRPTA tax that will be due on the sale of the U.S. real property by the foreign corporation.⁵³ FIRPTA also prevents any tax-free liquidation of a foreign corporation holding U.S. real estate⁵⁴ and prevents the use of other provisions of the Code that permit nonrecognition of gain.⁵⁵

Section 897(i) provides that if a foreign corporation holds a U.S. real property interest and, if under any tax treaty the foreign corporation is entitled to nondiscriminatory treatment with respect to that interest, the corporation can elect to be treated as a domestic corporation for purposes of Sections 897 and 6039C.⁵⁶ This section overrides the provisions of some tax treaties to which the United States is a party which prohibit the United States from taxing capital gains, other than capital gains from the sale of U.S. realty, realized by a resident of the treaty country.⁵⁷ Pursuant to treaties of this type, the sale of shares in a domestic corporation that is a USRPHC by a resident of the treaty country would ordinarily be exempt from U.S. taxation. FIRPTA, however, expressly provides that these treaty provisions will be honored only until December 31, 1984.⁵⁸

B. The 1982 and 1983 FIRPTA Regulations

The 1982 Regulations took effect immediately, were retroactive to June 19, 1980 as temporary regulations, and served as proposed regulations for the purpose of notice and public comment.⁵⁹ The 1982 Regulations issued were not complete, but they did set forth a procedure for establishing when a corporation is not a USRPHC, the rules governing the election by a foreign corporation to be treated as a domestic corporation under Section 897(i), and an explanation of the various information returns required under Section 6039C. The 1982 Regulations also made a start at providing rules regarding the furnishing of security to the IRS in lieu of filing information returns. Portions of the FIRPTA regulations other than the reporting regulations, particularly the security alternative

⁵³ See I.R.C. § 897(d)(1) (1982) (distributions of U.S. real property interests by foreign corporations are taxable despite other nonrecognition provisions, unless the distributee would be subject to FIRPTA taxation on a subsequent distribution of the distributed property, and the distributee's basis would not exceed the distributor's basis, plus any gain recognized to the distributor on the distribution).

⁵⁴ I.R.C. § 897(d)(2) (1982).

⁵⁵ I.R.C. § 897(e) (1982).

⁵⁶ I.R.C. § 897(i)(1) (1982).

⁵⁷ See, e.g., Agreement for the Avoidance of Double Taxation, Apr. 29, 1948, United States-Netherlands, arts. V, XII, 62 Stat. 1757, 1760, 1762, T.I.A.S. No. 1855.

⁵⁸ FIRPTA, *supra* note 4, § 1125(c), 94 Stat. at 2690 (not codified).

⁵⁹ T.D. 7832, 1982-2 C.B. 122, 122.

to reporting, are discussed when necessary for an understanding of the FIRPTA reporting requirements.

1. Establishing that a Corporation is not a USRPHC

Section 897(a) of the Code provides for taxation of the gains of a nonresident alien individual or a foreign corporation from the disposition of a U.S. real property interest.⁶⁰ A U.S. real property interest includes any interest in a domestic corporation unless the foreign taxpayer establishes to the satisfaction of the Secretary that the U.S. corporation is not a USRPHC.⁶¹ Treasury Regulation 6a.897-2 of the 1982 Regulations provided a burdensome procedure for establishing that a U.S. corporation is not a USRPHC. Under that regulation, a foreign taxpayer who disposed of an interest in a domestic corporation during a calendar year was subject to the tax imposed by Section 897(a) unless the taxpayer established that the corporation was not a USRPHC, or established under other regulations that the corporation did not hold any U.S. real property interests on the date of the taxpayer's disposition of his interest, or that the corporation recognized gain on the disposition of its U.S. real property interests.⁶²

In order to establish that a domestic corporation was not a USRPHC under the 1982 Regulations, a taxpayer was required to supply schedules of (1) all U.S. real property interests held by the corporation on the last day of the calendar year; (2) all U.S. real property interests disposed of by the corporation during the calendar year; (3) all real property interests located outside the United States and all other assets used in a trade or business held by the corporation on the last day of the calendar year; (4) all property described in (3) that was disposed of by the corporation during the calendar year; and (5) calculations illustrating that the corporation was not a USRPHC on any determination date during the calendar year.⁶³ Under the 1983 Regulations, which when final, will supersede the 1982 Regulations, the burden of establishing that a corporation is not a USRPHC has been reduced substantially and has been shifted from the taxpayer/shareholder to the corporation.⁶⁴

Under the 1983 Regulations, a domestic corporation can assume it is not a USRPHC if the total book value of its U.S. real property interests is twenty-five percent or less of the total book value of all other assets taken into account in determining USRPHC status.⁶⁵ "Book value," for purposes of making this determination, means the value at which the item is carried on the books of the corporation as long as this value is determined in accordance with generally accepted accounting princi-

⁶⁰ I.R.C. § 897(a)(1) (1982).

⁶¹ I.R.C. § 897(c)(1)(A)(ii) (1982).

⁶² Treas. Reg. § 6a.897-2(b) (1982).

⁶³ Treas. Reg. § 6a.897-2(d) (1982).

⁶⁴ Prop. Treas. Reg. § 6a.897-2(b) (1983).

⁶⁵ Prop. Treas. Reg. § 1.897-2(b)(2) (1983).

ples.⁶⁶ This "book value" concept eliminates the necessity of keeping a separate set of books for FIRPTA compliance purposes. Foreign shareholders of corporations meeting this "safe harbor" test need only ascertain in writing from the corporation that it is not a USRPHC, and that the status of the corporation as a non-USRPHC has been conveyed to the IRS, in connection with their disposition of stock. No further proof is necessary that there has not been a disposition of a U.S. real property interest.⁶⁷ A determination by a domestic corporation with foreign shareholders that it is not a USRPHC also saves it the trouble of filing form 6659, discussed below, as long as the corporation attaches to its tax return a statement to that effect.⁶⁸

2. *Election to be Treated as a Domestic Corporation*

Under Section 897(i) of the Code, a foreign corporation that holds a U.S. real property interest and that is entitled to nondiscriminatory treatment with respect to the disposition of its U.S. real property interests under a tax treaty can elect to be treated as a domestic corporation for purposes of Sections 897 and 6039C.⁶⁹ A foreign corporation will generally be entitled to nondiscriminatory treatment under a tax treaty if it has a "permanent establishment" in the United States.⁷⁰

A foreign corporation must make its Section 897(i) election by filing five documents: (1) a general statement identifying the foreign corporation, the applicable tax treaty, and the U.S. real property interests held by the corporation; (2) a binding waiver by the corporation of the benefits of the tax treaty; (3) an agreement by the foreign corporation to pay U.S. tax on the disposition of its U.S. real property interests as if it were a domestic corporation; (4) a consent to the election and its effects by each shareholder of the foreign corporation; and (5) a statement concerning prior dispositions of U.S. real property interests.⁷¹ In the event that an electing foreign corporation chooses to provide the IRS with security, it can substitute for the consent of each shareholder a statement that the consents have been received by the corporation and will be held for three years, and a blind itemization of the type, amount, and fair market value of the interests in the corporation held by each shareholder.⁷²

3. *Reporting and Security Regulations*

Under Section 6039C of the Code, information returns are required from any domestic corporation that is a USRPHC and that has some

⁶⁶ *Id.*

⁶⁷ Prop. Treas. Reg. § 1.897.2(g)(1)(i) (1983).

⁶⁸ See *infra* notes 79-110 and accompanying text.

⁶⁹ I.R.C. § 897(i)(1) (1982).

⁷⁰ See, e.g., Convention for the Avoidance of Double Taxation, Mar. 4, 1942, United States-Canada, art. III, 56 Stat. 1399, 1400, T.I.A.S. No. 989.

⁷¹ Prop. Treas. Reg. 1.897-3(c) (1983).

⁷² Prop. Treas. Reg. 1.897-3(c)(4)(ii) (1983).

foreign ownership; nominees holding interests in a USRPHC directly or indirectly for a foreign person; foreign corporations and foreign or domestic estates, trusts, and partnerships that have one or more "substantial investors" in U.S. real property; and any foreign person who holds U.S. real property with a fair market value of \$50,000 or more.⁷³ These information returns must be filed for each calendar year beginning with 1980.⁷⁴ Calendar year 1980 includes only the period from June 19, 1980 to December 31, 1980.⁷⁵ After calendar year 1983, information returns must be filed by May 15 of the year following the calendar year being reported.⁷⁶

In the event of a failure to file a return or a failure to furnish a notice or statement required by the Act, a penalty of \$25 per day will be imposed unless it can be shown that the failure was due to a reasonable cause and not to willful neglect.⁷⁷ The maximum penalty for any person except foreign individuals is \$25,000 for a calendar year. The maximum penalty for foreign individuals is \$25,000 or five percent of the fair market value of the foreign person's U.S. real property interests, whichever is less.⁷⁸

a. Information Returns

(i) Domestic Corporations and Nominees—Form 6659

Form 6659 must be filed by a domestic corporation if the corporation is a USRPHC during the calendar year or during any of the four previous calendar years and if, during the calendar year, one or more owners of interests in the corporation are foreign persons.⁷⁹ For example, assume that Apex, Inc., a North Carolina corporation, owns three pieces of unencumbered⁸⁰ and undeveloped real estate. One is in Georgia and has a fair market value of \$2 million; one is in North Carolina and has a fair market value of \$1 million; and one is in Belgium and has a fair market value of \$2 million. Apex has no other assets. X, a citizen and

⁷³ Treas. Reg. § 6a.6039C-1 to -5 (1982).

⁷⁴ Treas. Reg. § 6a.6039C-1(b) (1982).

⁷⁵ *Id.*

⁷⁶ Treas. Reg. § 6a.6039C-1(c) (1982).

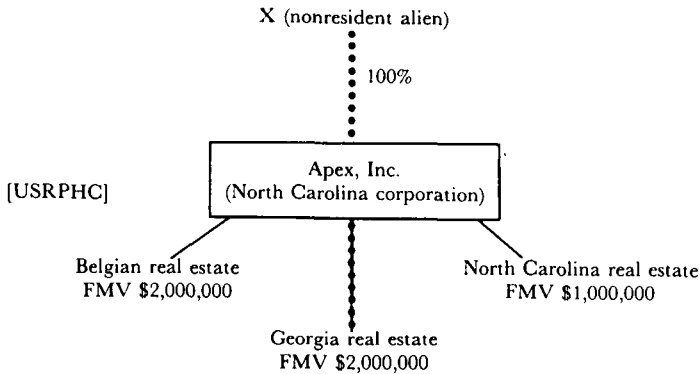
⁷⁷ I.R.C. § 6652(g) (1982).

⁷⁸ *Id.* See also Treas. Reg. § 6a.6652(g)-1 (1983), adopted in T.D. 7866, 1983-1 C.B. 354 (penalties for failure to file return). This regulation was issued as both a proposed and a temporary regulation.

⁷⁹ Treas. Reg. § 6a.6039C-2(a) (1982).

⁸⁰ A major improvement of the 1983 Regulations over the 1982 Regulations was the revision of the definition of "fair market value." The original and rather unrealistic definition did not take into account in any fashion debt against the property. Treas. Reg. § 6a.897-1(n) (1982). Fair market value, for purposes of making determinations under FIRPTA, no longer includes "the outstanding balance of debts secured by the property, but only if the debt proceeds were used to purchase or improve the property." Prop. Treas. Reg. § 1.897-1(o)(2)(iii) (1983). Two remaining problems with the definition, however, involve the treatment of a mortgage assumed by a foreign investor, and debt which represents a refinancing by the original foreign investor. The fear of the IRS is that financing is a method of extracting profit from the real property.

resident of Switzerland and a nonresident alien under U.S. law, owns all the stock of Apex. Apex is a USRPHC since the fair market value of its U.S. real property interests (\$3 million) equals or exceeds fifty percent of the fair market value of its U.S. real property interests (\$3 million), its interests in real property located outside the United States (\$2 million), and all other assets used or held for use in a trade or business (zero). Since X, a foreign person, owns an interest in Apex, Apex is obliged to file Form 6659 unless an exception applies.



There are several exceptions to the requirement that a domestic corporation, as described above, file Form 6659. First, if all classes of stock that were held by foreign persons were "regularly traded on an established securities market during the entire time" the foreign persons held the stock, the corporation need not file Form 6659.⁸¹ An established securities market is defined as a national securities exchange registered under the Securities Exchange Act of 1934;⁸² a foreign national securities exchange that is officially recognized, sanctioned, or supervised by government authority; or any over-the-counter market.⁸³ Second, if the domestic corporation provides security and has a security agreement with the IRS, the corporation need not file.⁸⁴

Form 6659 must also be filed by any nominee holding an interest, directly or indirectly, for a foreign person in a USRPHC, unless security is furnished by the corporation, the nominee, or another nominee in a chain of nominees; or unless the corporation or foreign person who is the ultimate owner of the interest files the form.⁸⁵ Further, both foreign and domestic nominees in a chain of nominees must file Form 6659, and must also notify the nominees above them in the chain that they must file

⁸¹ Treas. Reg. § 6a.6039C-2(a)(1) (1982).

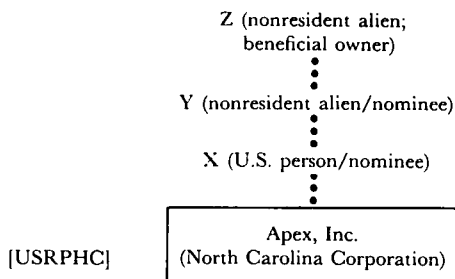
⁸² 15 U.S.C. § 78a-78kk (1982).

⁸³ Prop. Treas. Reg. § 1.897-1(m) (1983).

⁸⁴ Treas. Reg. § 6a.6039C-2(a)(2) (1982).

⁸⁵ Treas. Reg. § 6a.6039C-2(e)(1), (2) (1982). The term "nominee" is not defined, but IRS officials indicate it is used in the regulations in its ordinary legal sense to describe a natural person who holds property for another person.

Form 6659 if they hold for the foreign persons.⁸⁶ For example, assume that X, a U.S. person, holds an interest in Apex, Inc. on behalf of Y, a nonresident alien. Y holds an interest on behalf of Z, a nonresident alien. Unless an exception applies, X must file Form 6659 and must notify Y that Y must file Form 6659.



Form 6659 requires the following information: (1) the name, address, and identifying number (IRS employer identification number or social security number) of the person filing the return; (2) the name, address, and identifying number of any foreign person with an interest in the corporation on the last day of the applicable calendar year; (3) the name, address, and identifying number of any nominee holding an interest in the corporation, directly or indirectly, for a foreign beneficial owner on the last day of the calendar year; (4) a description of the amount of, and class or type of, interest held by each foreign person named in (2) or (3) above; (5) information concerning all dispositions during the calendar year of interests in the corporation by foreign persons or their nominees, including the date of disposition, description of the interest disposed, date of acquisition of interest, the sales price of the interest, adjusted basis in the interest, the fair market value of the interest, and the amount of gain or loss to the foreign person upon disposition of his interest in the corporation; (6) the same information required in (5) above with regard to the disposition of interests after December 31, 1979, but before June 19, 1980, to related persons; (7) the same information required by (5) for all distributions during the year of property by the corporation (other than distributions of the corporation's own stock); (8) a description of U.S. real property interests held directly or indirectly by the corporation at the end of the calendar year; (9) the name, address, and identifying number of any corporation in which the reporting corporation held an interest at any time during the calendar year, if such interest was a real property interest; and (10) the name, address, and identifying number of all foreign persons who received Section 301 distributions of U.S. real property interests from the USRPHC during the calendar year, along with a description of the distributed property, its

⁸⁶ Treas. Reg. § 6a.6039C-2(e)(1)(ii) (1982).

fair market value at the time of distribution, the USRPHC's adjusted basis in the distributed property, and the gain to the USRPHC on the distribution.⁸⁷

Ownership through bearer shares will not defeat reporting obligations under the Act.⁸⁸ In addition, in the event that a USRPHC does not know whether an owner of record in the USRPHC is a nominee or a foreign person, the USRPHC must send notices to such owners regarding nominee filing obligations by January 31 of the year following the appropriate calendar year.⁸⁹ A nominee must notify the next nominee in any chain of nominees within 20 days.⁹⁰ The reporting requirements imposed by the new regulations are a considerable incentive to provide security, or otherwise reach a security agreement with the IRS.

The revisions in the regulations regarding determination of USRPHC status do not directly alter reporting requirements under Section 6039C. USRPHCs with foreign shareholders are still required to file Form 6659. The revisions, however, substantially reduce FIRPTA compliance burdens for foreign shareholders, and for domestic corporations that are not USRPHCs, by making it easier to establish that the corporations are not USRPHCs.

(ii) Foreign Corporations, and Foreign or Domestic Partnerships, Trusts, and Estates—Form 6660

Form 6660 must be filed by any foreign corporation and any partnership, trust, or estate (whether foreign or domestic) that has a "substantial investor" in U.S. real property on any of the applicable determination dates during the calendar year.⁹¹ The reporting requirement does not apply if an entity otherwise required to report has provided security and has, in effect, a security agreement with the IRS for the calendar year.⁹²

A "substantial investor" in U.S. real property is defined as any foreign person who holds an interest in a partnership, trust, or estate (foreign or domestic), or any person who holds an interest in a foreign corporation, if the fair market value of the person's pro rata share of U.S. real property interests held by the entity is greater than \$50,000.⁹³ As originally defined under the 1982 Regulations, fair market value meant the price at which the property would change hands between an unrelated willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all relevant

⁸⁷ Treas. Reg. § 6a.6039C-2(b) (1982).

⁸⁸ Treas. Reg. § 6a.6039C-2(g) (1982).

⁸⁹ Treas. Reg. § 6a.6039C-2(d) (1982). Apparently, if a USRPHC *knows* that a shareholder is a foreign person, no notice is required.

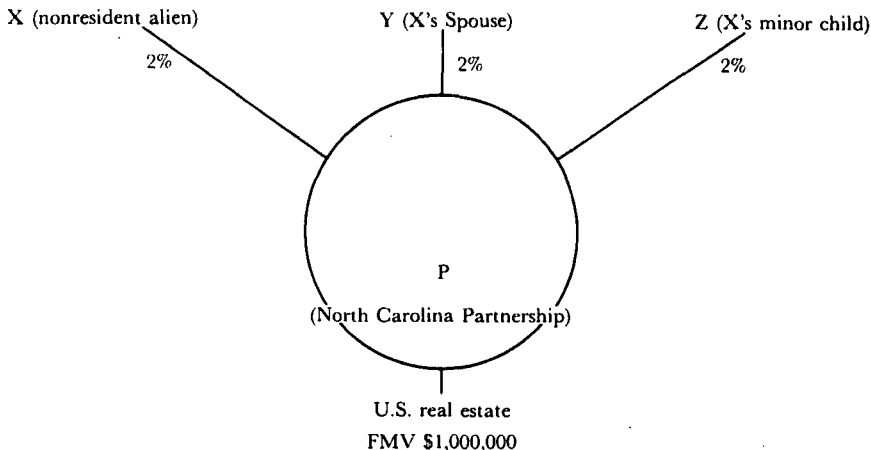
⁹⁰ Treas. Reg. § 6a.6039C-2(e)(ii) (1982).

⁹¹ Treas. Reg. § 6a.6039C-3(a) (1982).

⁹² *Id.*

⁹³ Treas. Reg. § 6a.6039C-3(b)(1) (1982).

facts. The fair market value of an interest was determined without regard to any mortgages or other encumbrances against the property.⁹⁴ Under the revised proposed regulations, however, the definition of fair market value excludes debt against the property incurred to acquire or improve the property.⁹⁵ In determining an individual's pro rata ownership share, interests held by a spouse or a minor child are attributed to the individual.⁹⁶ For example, assume that P, a North Carolina partnership, owns a single tract of unencumbered U.S. real estate with a fair market value of \$1 million. X, a nonresident alien, Y, his spouse, and Z, his ten-year-old child, each own two percent of the partnership. X is treated as owning six percent of the partnership and a six percent share of P's assets. Since the fair market value of X's pro rata share of P's U.S. real property interest is \$60,000, X is a "substantial investor" in U.S. real property, and P must file Form 6660 unless security is furnished.



For purposes of determining the U.S. real property interests of any entity described in this section, rules regarding direct and indirect ownership will be applied to any corporation, partnership, trust, or estate (whether foreign or domestic) in which the entity holds an interest.⁹⁷

To illustrate the direct and indirect ownership rules, assume that Apex N.V., a Netherlands Antilles corporation, owns a tract of unencumbered North Carolina real property with a fair market value of \$1 million. Apex N.V. also owns \$10 million worth of real property in Brazil. Apex is wholly owned by X, a Dutch corporation. X is in turn, forty percent owned by Y, a German limited partnership. Z, a Swiss individ-

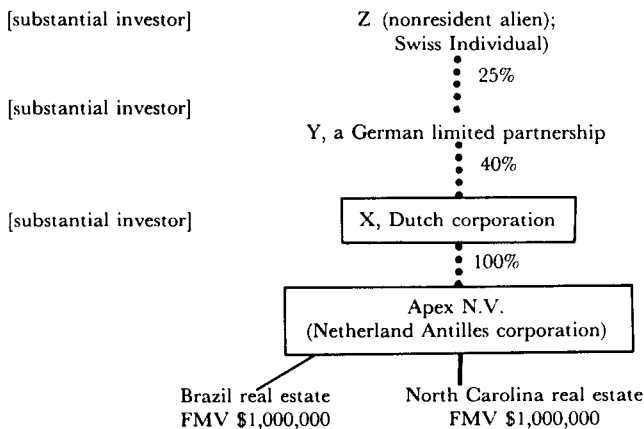
⁹⁴ Treas. Reg. § 6a.6039C-1(n) (1982).

⁹⁵ Prop. Treas. Reg. § 1.897-1(o)(2)(ii) (1983).

⁹⁶ Treas. Reg. § 6a.6039C-3(b)(1)(ii) (1982).

⁹⁷ Treas. Reg. § 6a.6039C-3(c)(1) (1982).

ual and a nonresident alien, holds a twenty-five percent interest in Y. Apex is an "entity" having a "substantial investor" (X) in U.S. real property. X's pro rata share of Apex's U.S. real property interest is 100 percent of \$1 million. Further, X itself is an "entity" having a "substantial investor" (Y) in U.S. real property. Y is treated as owning its pro rata share of X's U.S. real property interests, that is, forty percent of \$1 million or \$400,000. Finally, Y is an "entity" with a "substantial investor" in U.S. real property (Z) because Z's pro rata share of Y's U.S. real property interests (twenty-five percent of \$400,000 = \$100,000) exceeds \$50,000. Thus, unless an exception such as the furnishing of security applies, Apex, X, and Y must file Form 6660 because each has a "substantial investor" in U.S. real property. The fact that Apex has other assets that greatly exceed the value of its U.S. real estate is irrelevant to this reporting requirement.



The information required by Form 6660 is more extensive and detailed than that required by Form 6659.⁹⁸ It seems that one of the purposes of Form 6660 is to encourage foreign investors to post security with the U.S. tax authorities rather than report. The information required on Form 6660 includes: (1) the name, address, and identifying number of the person filing the return; (2) the name, address, and identifying number of the substantial investor in the entity during the calendar year; (3) the fair market value of each substantial investor's pro rata share of the U.S. real property interest held by the entity on the last day of the calendar year, but in the event of a disposition of an interest in a foreign corporation by a substantial investor, the fair market value shall be measured as of the date of disposition; (4) the amount and description of each class or type of interest in the entity held by a substantial investor on the last day of the calendar year; (5) a schedule of all United States real property interests held by the entity on the last day of the calendar year,

⁹⁸ Compare Treas. Reg. § 6a.6039C-2(b) (1982) with Treas. Reg. § 6a.6039C-3(e) (1982).

including a description of each interest and its location, adjusted basis, and fair market value; (6) the information required in (5) for the date of disposition of an interest in the entity by a substantial investor in a partnership, trust, or estate; (7) in the event of a distribution of a U.S. real property interest by an entity to a foreign person during the calendar year, the date of distribution, a description of the U.S. real property interest distributed, its adjusted basis and fair market value, and the name, address, and identifying number of the distributee; (8) a schedule of all dispositions of interest in a partnership, trust, or estate during the calendar year by any foreign person, including the name, address, and identifying number of the transferor, date of disposition, the amount and description of the type of interests disposed, the sales price, the fair market value of the interests, and, in the case of a disposition by a substantial investor, the fair market value of the substantial investor's pro rata share of the U.S. real property interest held by the entity on the date of disposition; (9) the name, address, and identifying number of any other entity with respect to which the partnership, trust, estate, or foreign corporation is a substantial investor; and (10) the name, address, and identifying number of any domestic corporation in which the entity holds an interest at any time during the year, if the interest is a U.S. real property interest.⁹⁹

If the owner of an interest in an entity has a foreign address, owns bearer shares, or is a nominee, the owner shall be treated as if he is a foreign person, unless the entity knows the owner to be a U.S. person.¹⁰⁰ In addition to the extensive information required by Form 6660, the regulations provide that in the event that a reporting entity does not have the information required by Form 6660, the entity "must obtain and supply the information."¹⁰¹ The fact that an owner of an entity required to report owns by means of bearer shares, or that interests in the entity are held by nominees, or that foreign bank secrecy laws prevent disclosure of the owner of the interest, does not constitute reasonable cause under the Code for failure to comply with these regulations.¹⁰² For example, assume that Apex, Ltd., a United Kingdom corporation, owns U.S. real property, and that X, a Liechtenstein Anstalt, owns all the shares of Apex. Z, a nonresident alien individual, owns all the shares of X which were issued in bearer form. If the directors of X do not know who owns its shares, then they must obtain that information and report that information to the IRS. Failure to do so will subject X to the \$25 per day penalty. Even if the law of Liechtenstein would protect Z's identity, the regulations provide that Apex must obtain and supply informa-

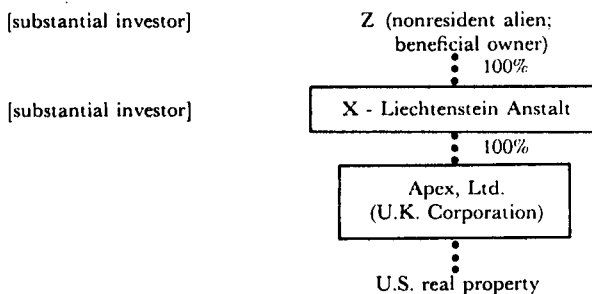
⁹⁹ U.S. Internal Revenue Service, Form 6660 (1983); Treas. Reg. § 6a.6039C-3(e) (1982).

¹⁰⁰ Treas. Reg. § 6a.6039C-3(f), (g) (1982).

¹⁰¹ Treas. Reg. § 6a.6039C-3(g) (1982).

¹⁰² *Id.*

tion regarding Z's identity. This provision effectively compels Apex to furnish security to the IRS.



Unless an entity required to file Form 6660 furnishes security to the IRS, the entity must also furnish a statement to all its substantial investors for each calendar year.¹⁰³ The statement must include certain items of information from the entity's Form 6660 and must inform the substantial investor that the information is being furnished to the IRS. Statements must be furnished no later than January 31 for the previous calendar year, except for calendar years 1980 through 1983.¹⁰⁴ Unlike the provisions for the USRPHC notification of certain shareholders, the 1982 Regulations require that an entity with substantial investors furnish statements by January 31, even if it is several rungs up the ownership ladder. Information returns are required in most cases no later than May 15 for the previous calendar year.¹⁰⁵

Regulations issued in January 1983¹⁰⁶ explain how the penalty provisions of the Act apply when a single entity fails to furnish a number of its substantial investors with statements. The entity is penalized \$25 per day for each failure to furnish a statement, but the maximum penalty that may be imposed on an entity for *all* its failures to comply with the Act and regulations for a single calendar year is \$25,000. Thus, the penalty simply accrues more quickly when an entity fails to file Form 6660 and furnish statements to substantial investors.¹⁰⁷

(iii) *Foreign Individuals—Form 6661*

Form 6661 must be filed by any foreign person who holds a U.S. real property interest, or by any nominee who holds a U.S. real property interest for a foreign person if (1) the real property interest held during

¹⁰³ Treas. Reg. § 6a.6039C-3(h) (1982).

¹⁰⁴ *Id.*

¹⁰⁵ The IRS previously indicated an intent to amend the regulations by changing reporting and notification deadlines for publicly traded partnerships. U.S. Internal Revenue Service, News Release IR-83-28, [1983] 10 STAND. FED. TAX. REP. (CCH) ¶ 6403 (Feb. 18, 1983). What these deadlines will be when final regulations are issued remains to be seen.

¹⁰⁶ Treas. Reg. § 6a.6652(g)-1 (1983).

¹⁰⁷ Treas. Reg. § 6a.6652(g)-1(g), example (3) (1983).

the calendar year was not used by the foreign person in the conduct of a trade or business in the United States during that calendar year; (2) the fair market value of the real property interest on any determination date was at least \$50,000; (3) the person is not required to file Form 6660; and (4) the person has not entered into a security agreement with the IRS.¹⁰⁸ The attribution and ownership rules for entities that must file Form 6660 also apply to foreign persons required to file Form 6661.¹⁰⁹

The information required by Form 6661 is less extensive than that required by Forms 6659 and 6660. The person filing Form 6661, however, is required to provide the following information: (1) the name, address, and identifying number of the person filing the return or the same information for the beneficial owner if the nominee is filing the return; (2) a description of all U.S. real property interests held by the foreign person on the last day of the calendar year, including the location of the interests, the date the interests were acquired, the name, address, and identifying number of any foreign person for whom the interests were acquired, and the fair market values of the interests; (3) a schedule of all dispositions of U.S. real property interests held by the foreign person during the calendar year, including a description of the interests, their fair market values, the adjusted bases, the interests of the foreign persons filing the return, and their locations; (4) in the case of a disposition of a U.S. real property interest to a foreign person, the transferee's name, address, and identifying number, the adjusted basis of the interest, and the fair market value of the property; and (5) the information required by (3) and (4) for all transfers of a U.S. real property interest to related foreign parties after December 31, 1979 and before June 19, 1980.¹¹⁰

b. Furnishing Security Instead of Filing Information Return(s)

The burden of filing information returns can be avoided if a person required to file an information return furnishes the District Director, Foreign Operations District ("Director") with security. The Director has the discretion to determine the amount of security necessary to ensure payment of any income tax on U.S. real property interests otherwise covered by the return.¹¹¹

(i) Types of Security

The 1982 Regulations suggested that a number of different types of security might be acceptable to the Director. The Director, however, retained "absolute discretion to determine the type and amount of secur-

¹⁰⁸ Treas. Reg. § 6a.6039C-4(a) (1982).

¹⁰⁹ Treas. Reg. § 6a.6039C-4(b) (1982) (incorporating by reference Treas. Reg. § 6a.897-1(e) (1982)).

¹¹⁰ U.S. Internal Revenue Service, Form 6661 (1983); Treas. Reg. § 6a.6039C-4(d) (1982).

¹¹¹ Treas. Reg. § 6a.6039C-5(a) (1982).

ity required."¹¹² The 1982 Regulations established six different types of security that may be acceptable. They are: (1) recorded security deeds on the U.S. real property with sufficient priority to protect the interests of the United States; (2) a sufficient amount of cash or other property in escrow; (3) letters of credit in a sufficient amount; (4) bonds with surety satisfactory to the Director; (5) evidence of a binding, voluntary withholding agreement that assures payment of U.S. income tax on the disposition of the U.S. real property interest; and (6) a binding agreement between the person required to report and an entity, for the entity's guarantee of payment of U.S. income tax, but only if the following conditions are met: (a) the entity is engaged in a trade or business in the United States; (b) the Director determines that the entity guaranteeing payment has substantial assets in the United States; (c) the Director is satisfied that the entity will not liquidate its assets and abscond without paying the tax; and (d) the Director is satisfied that the entity has assets sufficient to pay the tax.¹¹³

A two-page handout distributed by the IRS in early 1983 provided some information regarding an application for the first type of security agreement.¹¹⁴ The handout stated that the following information "must be forwarded with the application" for a security agreement: (1) address and description of property, and name of title holder; (2) basis of property; (3) estimated fair market value (FMV); (4) encumbrances and amount of each; (5) computation of amount of tax that would be owed using the formula in the 1982 Regulations; (6) formal proposal for a security agreement (including a draft of the agreement), the security instrument offered as collateral, and a statement of law and facts supporting the use of such an instrument; and (7) any powers of attorney.¹¹⁵ The handout, however, reflected only the IRS's first look at security provisions. Final regulations are likely to be considerably different from and more detailed than the 1982 Regulations in this area. The IRS will probably make the provision of security significantly easier for foreign taxpayers, particularly for large business enterprises, and may also provide a form of security agreement.

(ii) Amount

The amount of security required by the Director will be the excess of the sum of the fair market values, appraised within sixty days of the end of the calendar year, of all U.S. real property interests held by the entity during the calendar year over the sum of their adjusted bases, multiplied by a percentage equal to the greater of the maximum tax rate on

¹¹² Treas. Reg. § 6a.6039C-5(b) (1982).

¹¹³ *Id.*

¹¹⁴ Letter from Ray N. Weinstein, acting chief of the Special Procedures Staff of the Foreign Operations District of the I.R.S., to Kevin Conboy, Powell, Goldstein, Frazer & Murphy (December 15, 1982) (containing "Requests for Security Agreements").

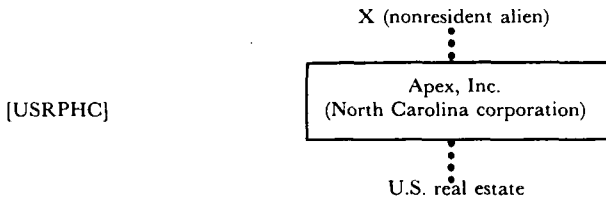
¹¹⁵ *Id.*

long term capital gain for the person required to file the return, or the maximum tax rate on long-term capital gains for a foreign person holding an interest in the person required to file.¹¹⁶ The Director, in his discretion, may determine that a greater or lesser amount than that provided by the formula will be required.¹¹⁷

The Director will not enter into a security agreement unless he is assured that the person or an owner of an interest in the person has paid or will pay any income tax on any disposition of a U.S. real property interest made during the calendar year for which the return is filed.¹¹⁸

(iii) *Effect*

Persons entering into valid security agreements with the Director for a calendar year are not required to file information returns, or to furnish notices to nominees or statements to substantial investors.¹¹⁹ Further, no one in the chain of ownership of the secured U.S. real property interest is required to take into account the fair market value of that property in determining whether such person is otherwise required to file.¹²⁰ Under the FIRPTA and its regulations, the furnishing of security by any entity in the chain of ownership breaks the chain of responsibility of those further up the chain for that property. For example, assume X, a nonresident alien, wholly owns all the shares of Apex, Inc., a USRPHC. If Apex, Inc. furnishes security to the IRS for all its U.S. real property interests, Apex need not file Form 6659, and X need not take into account his interest in Apex to determine whether he must file any information return. If X has no other direct or indirect interest in U.S. real property, he need not file any report with the IRS. The same rule applies even if X owns Apex through a chain of nominees or other entities.



(iv) *Duration and Renewal*

Security agreements are generally valid for one calendar year at a time. The 1982 Regulations, however, indicate that two year renewals are possible so long as all taxes have been paid on the taxpayer's prior

¹¹⁶ Treas. Reg. § 6a.6039C-5(c) (1982).

¹¹⁷ Treas. Reg. § 6a.6039C-5(b) (1982).

¹¹⁸ Treas. Reg. § 6a.6039C-5(d) (1982).

¹¹⁹ Treas. Reg. § 6a.6039C-5(f) (1982).

¹²⁰ *Id.*

dispositions of U.S. real property interests, and the amount of security is adjusted to reflect changes in the value of the property.¹²¹ Substantial changes making the security program workable should be included in the final regulations.

The 1982 Regulations indicate that the Director may, in his discretion, rely on representations made under penalty of perjury for the purpose of determining whether to enter into a security agreement.¹²² In the event that a security agreement is violated by a taxpayer, the Director retains the right to exercise any remedies available to him under the security agreement, and returns shall become due on the later of the due dates for the returns or thirty days from the date on which the violation first occurs.¹²³ If a security agreement is not renewed, the person must file the appropriate forms. Security is not released unless the person proves that all applicable forms have been filed and taxes have been paid.¹²⁴ Any interest that accrues on the collateral will go to the beneficial owner of the collateral when the security is released.¹²⁵ An application for a security agreement must be made to the Director within thirty days of the close of the calendar year for which the security agreement is desired.¹²⁶

C. Summary and Prospects

Assuming that the 1982 Regulations under Section 6039C go into effect without substantial change, it is crucial for foreign investors who own U.S. real property with a fair market value of more than \$50,000 to decide whether to protect their confidentiality by furnishing the IRS with security, or whether to file information returns that disclose the identity of individual foreign investors. Substantial changes, however, *are* likely, and those changes will probably make both reporting and providing security easier. Among the changes that can be anticipated are: (1) simplification of the information returns; (2) a reduction in the number of dates on which FIRPTA determinations must be made; (3) the IRS's release of a standard form of security agreement; (4) a more practical way of determining property value for security providers than the present system of annual property appraisals; and (5) longer-term renewals for security agreements.¹²⁷

The purpose of FIRPTA is to ensure that nonresident aliens and foreign corporations pay federal income tax on gain from the disposition of interests in U.S. real property. To ensure payment of the tax, a com-

¹²¹ Treas. Reg. § 6a.6039C-5(g) (1982).

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ Treas. Reg. § 6a.6039C-5(h) (1982).

¹²⁷ Telephone conversations with Internal Revenue Service and Treasury Department officials involved with drafting the FIRPTA regulations.

plex and burdensome reporting system has been established. As an alternative, however, foreign investors can furnish security to the IRS for the payment of taxes. The latter system should have the advantages of simplicity and protection of investor identity, but the 1982 Regulations did not have those advantages. If the final FIRPTA regulations improve the security system, it will be a welcome alternative to the reporting scheme. Relaxed reporting requirements would also be most welcome. If neither is forthcoming, foreign investors and those who represent them must look to Congress for relief. Whether the Administration's plan for withholding will bring true relief remains to be seen.¹²⁸

IV. State Reporting Requirements¹²⁹

Approximately ten states have their own reporting requirements for foreign investors acquiring real estate. About thirty states, however, impose restrictions on foreign investment. It is important to be aware of these state reporting requirements and restrictions.

None of the thirty states imposes an absolute ban on foreign investment, but the restrictions can be significant. Some states impose restrictions on foreign acquisitions of agricultural land or of publicly-owned land only.¹³⁰ Other states condition land ownership on a reciprocity principle, either that a U.S. person is able to own land in similar fashion in the foreign investor's home land,¹³¹ or that the foreign investor's government is at peace with the government of the United States.¹³² Some states impose restrictions on the amount of land that a foreign investor can acquire.¹³³ Finally, some states impose limits on the length of time a foreign investor can own his real estate.¹³⁴ These categories of restrictions are imposed both singly and in combination.

North Carolina imposes no restrictions or reporting requirements on foreign investors.¹³⁵ North Carolina law, however, requires the Secretary of State to collect and maintain a file of all information contained in

¹²⁸ For a summary of the Administration's plan, see U.S. Dep't of the Treasury, Department of the Treasury Fact Sheets on Revenue Proposals Contained in the Administration's Fiscal Year 1985 Budget, reprinted in 1984 DAILY TAX REP. (BNA) No. 22, at S-57 to S-58 (Special Supp., Feb. 2, 1984).

¹²⁹ The author is indebted for this summary to Hugh M. Brodkey and the Chicago Title Insurance Company for their publication summarizing state restrictions on foreign investment. See H. BRODKEY, FOREIGN INVESTMENT IN U.S. REAL ESTATE: THE ROLE OF STATE RESTRICTIONS IN STRUCTURING THE TRANSACTIONS (1978 & Supp. 1979 & Supp. 1982).

¹³⁰ See, e.g., IOWA CODE ANN. § 567.3 (West Supp. 1982) (nonresident aliens cannot acquire an interest in agricultural land unless it is fewer than 320 acres, and is purchased for nonfarm use).

¹³¹ See, e.g., WYO. STAT. § 34-15-101 (Supp. 1983); N.C. GEN. STAT. § 64-3 (1981) (inheritance rights only).

¹³² See, e.g., N.J. STAT. ANN. §§ 36:3 to 36:18 (West 1982).

¹³³ See, e.g., S.C. CODE § 27-13-30 (1976) (limit of 500,000 acres on a single foreign person's investment in real estate).

¹³⁴ See, e.g., ILL. ANN. STAT. ch. 6, § 2 (Smith-Hurd Supp. 1982).

¹³⁵ N.C. GEN. STAT. § 64-1 (1981). But see N.C. GEN. STAT. § 64-3 (1981) (inheritance rights of nonresident aliens subject to reciprocity provision).

reports made to the federal government by aliens, concerning the foreign ownership of North Carolina real estate.¹³⁶

Georgia, on the other hand, has both restrictions and reporting requirements applicable to foreign investors. The acquisition of Georgia real property is limited to nationals of countries whose governments are at peace with the government of the United States.¹³⁷ In addition, Georgia law requires the reporting of land acquisition and ownership by "alien corporations," that is, corporations incorporated outside the United States.¹³⁸ The law, however, does not require reporting by foreign persons who acquire Georgia real property directly, or by Georgia corporations that are owned by alien corporations. Thus, the reporting requirement can be avoided for the relatively low price of forming a Georgia corporation. The Georgia law is widely disregarded, although title insurance companies are increasingly requiring compliance with the reporting requirement. The Georgia Secretary of State has failed to prepare forms for reporting under the reporting law. Attempts to repeal the law, however, have been unsuccessful, and in light of the penalty provision for non-compliance — the alien corporation is "not entitled to own, purchase or sell real property," — repeal of the law or increasing compliance is to be expected.

V. Conclusion

Foreign investment reporting requirements are, from the foreign investor's viewpoint, cumbersome. Foreign investors obtain no benefit by complying with these requirements; compliance simply prevents foreign investors from being penalized. The compliance level for these reporting schemes is low. Nonetheless, counsel for foreign investors or for U.S. persons involved in foreign investment transactions should urge compliance with these three federal reporting laws. The Commerce and Agriculture Department's reporting schemes have been in existence for some time and Congress is not likely to repeal them in the near future. U.S. attorneys should no more counsel foreign investors to disregard these laws than they should counsel foreign investors to disregard U.S. labor or tax law.

Form BE-14, discussed above, puts the attorney in an awkward position. The prudent counselor will best represent both his client's interest and his own by taking a few moments to explain briefly the reporting provisions and to indicate that the attorney, or some other professional involved in the initial investment transaction, will prepare and file the initial investment reporting forms.¹³⁹ Filing the initial forms will help

¹³⁶ N.C. GEN. STAT. § 64-1.1 (1981).

¹³⁷ GA. CODE ANN. § 79-303 (Supp. 1982).

¹³⁸ *Id.* § 26-3414 (Supp. 1982).

¹³⁹ Large law firms and accounting firms that regularly file such reports will benefit from, and reduce client fees by, the prudent use of paralegals in preparing investment transaction reports.

the attorney meet his order obligations, and providing these agencies with the name and address of the investor will place the burden of ongoing compliance on the foreign investor (unless the foreign investor needs or desires assistance in complying with his continuing obligations). When the initial investment transaction centers on the acquisition of U.S. real estate, it is a good idea to make the signing of Forms BE-13 and ASCS-153 a part of the closing agenda.

The one variable involved in filing foreign investment report forms is the question whether the foreign investor desires to preserve his anonymity. If the foreign investor wishes to preserve his anonymity, planning may be required in the structuring of the investment.

Finally, the tax that FIRPTA imposes is virtually certain to remain, despite Senator Barry Goldwater's attempts of repeal.¹⁴⁰ Other than the tax itself, however, little else about FIRPTA is certain.

¹⁴⁰ See S. 1915, 98th Cong., 1st Sess. (1983).

